Community State Bank v. Strong[*]

I. INTRODUCTION

Widening an existing split among the circuit courts, the Eleventh Circuit held that a federal district court has subject matter jurisdiction over a petition to compel arbitration under Section 4 of the Federal Arbitration Act (FAA) if the underlying dispute to be arbitrated itself states a federal question.[1] By holding that federal question jurisdiction exists *and* extends over the entire case, the court has allowed out-of-state banks to sidestep the regulations of state usury laws and has provided a weapon to the predatory-lending industry's arsenal.

II. CASE FACTS AND PROCEDURAL HISTORY

On February 6, 2004, the respondent-appellee James E. Strong visited a "payday loan" store, Georgia Cash America, a Georgia corporation, and took out a payday loan for two hundred dollars ($200), which he agreed to repay by March 3, 2004.[2] The loan agreement Mr. Strong entered into was similar to many other payday loans, which characteristically are for small amounts of money, must be repaid within a few weeks, and carry a high interest rate.[3] The promissory note stipulated that the contract involved interstate commerce and was subject to the FAA. The note provided that the respondent-appellee's signing of the note served as an acknowledgement that any disputes related to the loan would be resolved by binding arbitration.[4]

Georgia's usury laws align with the laws of several other states by banning such high interest payday loans, and clearly prohibit a Georgia bank from extending these loans to Georgia residents.[5] The involvement of out-of-state banks complicates the matter, because Section 27 of the Federal Depository Insurance Act (FDIA) expressly permits state-chartered, FDIC-insured banks to extend the interest rates of the state in which the bank is chartered to customers outside that state.[6] In spite of any Georgia law that expressly bans high-interest payday loans, an out-of-state bank is allowed to

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[*] Cmty. State Bank v. Strong, 485 F.3d 597 (11th Cir. 2007).

[1] Cmty. State Bank v. Strong, 485 F.3d 597, 600 (11th Cir. 2007).

[2] *Id.* at 601.

[3] *Id.* at 600. The loan Mr. Strong entered into carried a finance charge equivalent to an annual interest rate of 252.7%. *Id.* at 601.

[4] *Id.*

[5] *Id.* at 600.

[6] *See* 12 U.S.C. § 1831d(a) (2000).

charge Georgia residents any rate, so long as the rate is permitted by the law of the state in which the bank is chartered.[7]

The state of the law is murky when an out-of-state bank partners with an in-state payday loan store to market the bank's loans to persons within the state in which the loan store sits. Georgia Cash America, the Georgia corporation whose store Mr. Strong visited to procure his loan, is an affiliate of petitioner-appellants Cash America Financial Services, Inc., and Cash America International, Inc., corporations incorporated in Delaware and Texas, respectively.[8] Together, these companies market, service, and collect payday loans on behalf of petitioner Community State Bank (the bank), an FDIC-insured bank chartered by the state of South Dakota.[9] The note identified the bank as the lender, and stipulated that although the bank partnered with the Cash America companies to service the loan, the Cash America companies were not owned by, operated by, or affiliated with the bank and had no authority to make loans.[10]

Instead of repaying the loan, Mr. Strong filed suit in Georgia state court against defendants Georgia Cash America, Cash America International, and Daniel Feehan, the Chief Executive Officer of the Cash America corporations.[11] The state court complaint set forth six causes of actions, all essentially alleging that the loan was unenforceable because it was usurious.[12] Strong argued that the bank had very limited actual involvement in the loan and that the Cash America companies were the real lenders.[13] Strong alleged Cash America's partnership with Community State Bank was a deceptive act, undertaken solely to side-step Georgia's usury laws.[14] Regarding the arbitration provision, in his complaint Strong argued the provision was unenforceable and unconscionable.[15] Strong's complaint specifically set forth several other arguments—presumably to prevent the removal of the case to federal court—including that the complaint did not raise any federal causes of action, did not state any causes of action against any bank, and did not seek recovery in excess of $75,000.[16]

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[7] *See id.*

[8] *Cmty. State Bank*, 485 F.3d at 601.

[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] *Id.* at 601–02.

[13] *Id.* at 602.

[14] *Cmty. State Bank*, 485 F.3d at 602.

[15] *Id.*

[16] *Id.*

After the filing of Mr. Strong's state court action, the defendants in the state case responded by serving Strong with a Notice of Intent to Arbitrate pursuant to the terms of the loan agreement.[17] The state-action-defendants' letter to Mr. Strong stated that the loan was lawful.[18] The letter averred that the bank was the true lender, that none of the Cash America companies was the lender, and therefore that the interest rate charged for the loan was governed and allowed by federal law.[19] The arbitration notice demanded that Mr. Strong dismiss his state court action and participate in binding arbitration.[20] In a letter in response to the arbitration notice, Mr. Strong reiterated his belief in the truth of the averments contained in his state court complaint and informed the defendants that he intended to further pursue his action in Georgia state court.[21]

In the face of Mr. Strong's resistance to abandon his state court action, his adversaries launched a two-pronged attack. First, the state-court defendants removed the state court action to the United States District Court for the Northern District of Georgia, claiming that 12 U.S.C. § 1831d completely preempts usury claims under Georgia state law.[22] Upon a claim that the district court had improperly granted removal, Mr. Strong moved the court to remand the case for lack of subject matter jurisdiction.[23]

While Mr. Strong's motion to remand was pending, his opponents moved—under the FAA—to stay the proceedings and compel arbitration of Mr. Strong's claims.[24] Mr. Strong mounted an opposition to the defendants' motion to compel arbitration, and Mr. Strong moved the court to grant expedited discovery concerning the enforceability of the arbitration agreement.[25]

The district court granted the motion to remand the case to state court, and in so doing held that 12 U.S.C. § 1831d does not completely preempt the Georgia usury law claims against the defendants.[26] The district court's grant of Strong's motion to remand essentially held that Strong's state action

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[17] *Id.*

[18] *Id.*

[19] *Id.*

[20] *Cmty. State Bank*, 485 F.3d at 602.

[21] *Id.*

[22] *Id.*

[23] *Id.*

[24] *Id.*

[25] *Id.*

[26] *Cmty. State Bank*, 485 F.3d at 602.

complaint did not state a federal question, and consequently that removal was improper.[27]

The second arm of the opposition's plan was unleashed when the state court defendants—joined by the bank and Cash America Financial Services—commenced the independent action, which was the root of the appeal before the Eleventh Circuit Court.[28] The petitioners filed a Verified Petition to Compel Arbitration and Stay Judicial Proceedings under Sections 3 and 4 of the FAA.[29] In their verified petition, the petitioners alleged that the promissory note signed by Strong contained an arbitration agreement, under which all disputes regarding the loan must be resolved through binding arbitration; that the opposing sides disputed whether 12 U.S.C. § 1831d or state law governs the loan; that Strong refused the demand to arbitrate; and that Strong's refusal to arbitrate threatened the petitioners with severe injury.[30] The petitioners claimed the district court had jurisdiction pursuant to federal question jurisdiction.[31] The petitioners asserted that in arbitration they would seek resolution of Strong's state-court claims and a declaration that the loan is governed by 12 U.S.C. § 1831d and therefore lawful.[32]

Strong, in a motion in opposition to the independent FAA petition, argued the court lacked subject matter jurisdiction over the matter.[33] Strong claimed the opposing parties were simply restating the claims of his state-court complaint.[34] Strong argued that should the court rule that state usury claims against state-chartered banks are completely preempted by federal law, he had not raised any claims against any bank, and thus there was no federal question contained in his state-court claims.[35] If the state-court complaint did not present a federal question, Strong argued the district court was without subject matter jurisdiction.[36]

The district court granted Strong's motion and held that there was no federal question jurisdiction.[37] The district court dismissed the independent

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[27] *Id.* at 602–03.

[28] *Id.* at 603.

[29] *Id.*

[30] *Id.* at 603–04.

[31] *Id.* at 604.

[32] *Cmty. State Bank*, 485 F.3d at 604.

[33] *Id.*

[34] *Id.*

[35] *Id.*

[36] *Id.*

[37] *Id.*

FAA petition to compel arbitration due to the court's lack of jurisdiction over the subject matter.[38] Specifically, the district court held that 12 U.S.C. § 1831d does not completely preempt claims under Georgia's usury laws against state-chartered banks, and even if it did, Strong's state-court complaint set forth no claims against any bank.[39]

The petitioners then filed their appeal of the district court's order granting the dismissal of its FAA petition to compel arbitration.[40]

III. THE COURT'S HOLDING

Because the parties agreed that diversity jurisdiction was not present in the case, the only issue for the Eleventh Circuit Court was whether the district court had jurisdiction over the subject matter based on a federal question.[41] The court construed the law in its circuit to grant district courts subject matter jurisdiction over FAA Section 4 petitions "if [the court] would have subject matter jurisdiction over the dispute-to-be-arbitrated."[42] The court held that it is appropriate for a district court to "look through" the arbitration petition at the underlying dispute in order to determine whether there is a federal question.[43]

To arrive at its holding in *Strong*, the Eleventh Circuit said it was bound to follow its own precedent, as announced in *Tamiami Partners Ltd. ex rel. Tamiami Development Corp. v. Miccosukee Tribe of Indians of Florida*.[44] In *Tamiami*, the case posited to the court the question of whether federal question jurisdiction existed over a dispute concerning an agreement that incorporated the Indian Gaming Regulatory Act (IGRA).[45] The court held in *Tamiami* that federal question jurisdiction exited over the petition to compel arbitration under IGRA because the court would have subject matter jurisdiction over the underlying dispute.[46] A footnote in *Tamiami* analogized the situation then before the court with the FAA, and said that federal

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[38] *Cmty. State Bank*, 485 F.3d at 604.

[39] *Id.*

[40] *Id.*

[41] *Id.* at 605.

[42] *Id.* at 606.

[43] *Id.*

[44] *Cmty. State Bank*, 485 F.3d at 606 (citing Tamiami Partners Ltd. *ex rel.* Tamiami Dev. Corp., v. Miccosukee Tribe of Indians of Florida, 177 F.3d 1212 (11th Cir. 1999)).

[45] *Tamiami*, 177 F.3d at 1222.

[46] *Id.* at 1222–23.

question jurisdiction under the FAA exists if the district court would have jurisdiction over the subject matter of the underlying claim to be arbitrated.[47]

This court declared it must look at the petitioners' statement of the dispute to decide the issues before it.[48] In deciding the present appeal, the court criticized the district court for too easily concluding that the petitioners sought to arbitrate the same claims as the respondent offered in its state-court complaint.[49] The court stated that its reading of the petitioners' petition to compel arbitration showed that petitioners sought to arbitrate two disputes: the state-court claims presented in the respondent's state-court complaint, and the petitioner's affirmative claim that the loan is governed by federal law.[50] "If *either* of these two disputes-to-be-arbitrated states a federal question, the district court has subject matter jurisdiction over the petition to compel."[51] The district court looked at only the issue of whether issues were present in the petition distinct from issues contained in the state-court complaint, but the circuit court looked at the petitioners' claim that federal law preempts state usury law.[52]

The next step in the circuit court's analysis involved the court "looking-through" the claims to the underlying dispute in order to determine if the underlying claims presented a federal question.[53] The court found there was a federal question because the underlying facts in the case could have given rise to a federal action under the federal Racketeer Influenced and Corrupt Organizations Act (RICO), and that it did not matter that Strong chose not to bring such an action but instead chose to assert only state law causes of action.[54] Since the state-law claims and the federal declaratory judgment arose from a common nucleus of operative fact, the court held that the district court did have subject matter jurisdiction over the entire claim.[55]

IV. THE IMPACT OF THE COURT'S DECISION

Writing a separate concurrence, Judge Marcus announced the many reasons why he considers the effect of the majority holding (which he also

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[47] *Id.* at 1223 n.11.

[48] *Cmty. State Bank*, 485 F.3d at 606.

[49] *Id.*

[50] *Id.* at 607.

[51] *Id.*

[52] *See id.*

[53] *See id.* at 607–08.

[54] *Cmty. State Bank*, 485 F.3d at 612.

[55] *Id.* at 612–13.

authored) wrong or at least "ill-considered."[56] Judge Marcus announced his belief that the majority opinion is correct because *Tamiami* is binding on the court, and that the rule is ripe for en banc review or review by the Supreme Court.[57]

Several courts in various circuits are of the mindset that federal question jurisdiction over an FAA Section 4 petition to compel arbitration is not dependent on the nature of the underlying dispute to be arbitrated.[58] Contrary to the holding in *Strong*, the better reading of Section 4 of the FAA is that the statute's plain language forbids federal courts from adjudicating the merits of the dispute to be arbitrated and allows them to rule on only the arbitrability of the dispute by interpreting the parties' contract. Federal courts should hear Section 4 petitions only if the parties are diverse. Even the author of the majority opinion in *Strong* agrees that the majority opinion is not the best interpretation of Section 4 of the FAA.

Marcus M. Van Wey

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[56] *Id.* at 614 (Marcus, J., concurring).

[57] *Id.* at 614–15.

[58] *See, e.g.*, Kasap v. Folger Nolan Fleming & Douglas, Inc., 166 F.3d 1243, 1246 (D.C. Cir. 1999); U.S. Bank Nat'l Ass'n ND v. Strand, 243 F. Supp. 2d 1139, 1141–45 (D. Or. 2002); Westmoreland Capital Corp. v. Findlay, 100 F.3d 263, 267–69 (2d Cir. 1996); Smith Barney, Inc., v. Sarver, 108 F.3d 92, 94 (6th Cir. 1997); Wisconsin v. Ho-Chunk Nation, 463 F.3d 655, 659 (7th Cir. 2006).